

## Message Text

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ACTION ARA-10

INFO OCT-01 AF-06 EUR-12 EA-06 NEA-09 ISO-00 CIAE-00

DODE-00 PM-03 H-01 INR-07 L-02 NSAE-00 NSC-05 PA-01

RSC-01 PRS-01 SP-02 SS-15 USIA-06 EB-07 COME-00 FRB-03

TRSE-00 STR-01 CEA-01 CIEP-01 OMB-01 FEA-01 INT-05

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AMEMBASSY KUWAIT

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AMEMBASSY LIMA

AMEMBASSY LONDON

AMEMBASSY PORT OF SPAIN

AMEMBASSY QUITO

AMEMBASSY TEHRAN

AMEMBASSY TRIPOLI

AMEMBASSY VIENNA

AMCONSUL DHAHRAN

USMISSION OECD PARIS

C O N F I D E N T I A L CARACAS 915

E.O. 11652: GDS

TAGS: ENRG, VE

SUBJECT: GOV RATIONALE FOR NEW OIL TAX

REF: (A) CARACAS 836; (B) CARACAS 871

1. SENIOR MINES MINISTRY OFFICIAL WHO WAS INVOLVED IN PREPARING  
NEW OIL TAX STRUCTURE PROVIDED FOLLOWING INFORMATION ON WHAT HAS  
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TRANSPIRED.

A. IN CALCULATION OF NEW TAX PAID COST, GOV COMPARED 31 API VENEZUELAN CRUDE WITH 34 API MIDDLE EAST CRUDE;  
B. AVERAGE PRODUCTION COST OF CRUDE AND PRODUCT USED IN ARRIVING AT NEW GOVERNMENT TAKE WAS \$1.14, WHICH WAS ACTUAL 1974 COST. AT BEGINNING OF 1974, GOV ESTIMATED THAT PRODUCTION COST WOULD AVERAGE \$0.95 PER BARREL, BUT AS PRODUCTION DECLINED THROUGHOUT YEAR, THE PRODUCTION COST INCREASED;  
C. AVERAGE ROYALTY FOR ALL VENEZUELAN CRUDES IS \$2.14;  
D. LOWERING OF FREIGHT RATE FROM \$1.91 TO \$1.13 OFFSETS INCREASED PRODUCTION COST AND MAINTAINS COMPETITIVE EDGE VIS A VIS MIDDLE EAST OIL.

2. SOURCE DECLINED TO PROVIDE DATA ON HOW MUCH OF INCREASED GOVERNMENT TAKE WILL BE PASSED ON BY OIL COMPANIES, WHILE ADMITTING MINISTRY POSSESSES THIS INFORMATION IN CONFIDENTIAL FINANCIAL REPORTS COMPANIES ARE OBLIGED TO SUBMIT. HE DID SAY THAT IT WOULD BE REASONABLE TO ASSUME THAT COMPANIES ARE ABLE TO PASS AS MUCH AS \$0.20 OF AVERAGE \$0.38 INCREASE IN GOVERNMENT TAKE PUBLICLY ANNOUNCED AS REPORTED REFTELS. USING THIS ROUGH ESTIMATE, ONE COULD ARRIVE AT AVERAGE NEW TRANSFER PRICE OF \$10.32 ASSUMING PREVIOUS TRANSFER PRICE ESTIMATE OF \$10.12 WAS VALID. THIS ASSUMPTION WOULD INDICATE THAT OIL COMPANIES WILL HAVE TO ABSORB \$0.18 PER BARREL OF NEW GOVERNMENT TAKE.

3. COMPOSITION OF CURRENT VENEZUELAN EXPORTS OF PRODUCTS TO WORLD, ACCORDING TO SOURCE, IS: NUMBER SIX FUEL OIL WITH HIGH SULPHUR CONTENT - 60 PERCENT, NUMBER SIX FUEL OIL WITH LOW SULPHUR CONTENT - 21 PERCENT, NAPHTA 10 PERCENT, NUMBER TWO FUEL OIL - 6.1 PERCENT, ASPHALT AND LUBS - 2.9 PERCENT. VENEZUELAN EXPORTS TO THE U.S. MARKET HAVE FOLLOWING COMPOSITION: NUMBER SIX FUEL OIL (ALL SULPHUR CONTENTS) - 85 PERCENT, NAPHTHA 16 PERCENT, NUMBER TWO FUEL OIL - 4.5 PERCENT, ASPHALT AND LUBS - 4.5 PERCENT. NUMBER TWO FUEL OIL, ON WHICH GOV HAS HIGHER TAX REALIZATION, BECAUSE OF WEAK U.S. PRICE HAS BEEN MIXED WITH NUMBER SIX FUEL OIL BY OIL COMPANIES. BY REDUCING TEV FOR NUMBER TWO FUEL OIL, RESULTING IN A LOWER TAX PAID COST TO COMPANIES, GOV EXPECTS THAT COMPOSITION OF OIL EXPORTS WILL SHIFT TO AT LEAST 10 PERCENT MORE NUMBER TWO FUEL OIL AND, THEREBY, INCREASE OVERALL GOVERNMENT TAKE. THIS ASSUMES THAT OIL COMPANIES WILL NOW HAVE THE INCENTIVE TO BLEND LESS OF THE

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NUMBER TWO AND, INSTEAD, SHIP IT AS STRAIGHT NUMBER TWO. THE TEV FOR NUMBER TWO, ALTHOUGH NOW REDUCED, IS STILL ABOVE NUMBER SIX FUEL OIL.

4. GOV STRATEGY IS TO LAND NUMBER TWO FUEL OIL ON THE U.S. EAST COAST AT NO MORE THAN \$13 PER BARREL. THE NEW TAX STRUCTURE IS DESIGNED TO LAND NUMBER TWO VENEZUELAN FUEL OIL AT \$0.23 LESS THAN \$13 PER BARREL. AT THIS PRICE, THE GOV BELIEVES THAT NO

EUROPEAN NUMBER TWO WILL BE OFFERED IN COMPETITION, ESPECIALLY FROM ITALY WHICH THE SOURCE STATED IS THE TRADITIONAL EUROPEAN SUPPLIER AND VENEZUELAN COMPETITOR FOR THIS PRODUCT TO THE U.S. THE REDUCTION OF TEVS FOR MOTOR GASOLINE AND NAPHTHA ARE VERY SLIGHT AND INTENDED TO BRING THESE PRODUCTS IN LINE WITH U.S. DOMESTIC PRICES FOR SIMILAR PRODUCTS.

5. ASKED HOW HE ARRIVED AT \$13 FIGURE ABOVE, THE MINISTRY SOURCE SAID THAT PRESIDENT FORD WAS QUOTED IN NEW YORK TIMES LAST WEEK AS SAYING THAT U.S. CRUDE OIL PRICE WILL BE \$13 AFTER NEW IMPORT TARIFFS GO INTO EFFECT. THE MINISTRY OBVIOUSLY BELIEVES THIS TO BE ITS COMPETITION PRICE.

6. THERE WAS INTENSE INFIGHTING BETWEEN MINISTRIES OF MINES AND FINANCE OVER AMOUNT OF NEW TAX. ACCORDING TO SOURCE, FINANCE WANTED EITHER GOVERNMENT TAKE TO BE INCREASED BY FLAT \$1.00, WHICH WOULD MORE OR LESS EQUATE WITH MIDDLE EAST TAKE AND OPEC FORMULA, OR ALTERNATIVELY FOR THE OIL COMPANY TAX RATE TO BE RAISED TO 85 PERCENT. MINES COUNTERED WITH QUESTION OF WHETHER GOV NOW READY TO ASSUME COMPLETE OPERATION OF OIL INDUSTRY, SINCE FINANCE PROPOSALS WERE CONFISCATORY AND WOULD FORCE PRIVATE OIL COMPANIES TO SHUT DOWN. MINES MINISTRY PROPOSED OIL COMPANY TAX RATE BE INCREASED FROM 63.5 PERCENT TO 67 PERCENT. PRESIDENT PEREZ REPORTEDLY CHOSE FINAL COMPROMISE PACKAGE OF 72 PERCENT COMPANY TAX RATE WITH REDUCED TEVS.

7. GAZETTE BEING PUBLISHED TODAY WILL CONTAIN SOME ERRORS, PARTICULARLY TEV FOR NAPHTHA. CORRECTIONS BEING PREPARED BY MINES AND WILL APPEAR IN SUBSEQUENT GAZETTE.

8. SOURCE CONFIRMED THAT VENEZUELAN OIL PRODUCTION WILL QUICKLY DROP TO 2.6 MILLION BARRELS PER DAY. ASKED WHETHER THIS IS DUE TO CONSERVATION OR PRODUCTION PROBLEMS, HE SAID FRANKLY THAT CONFIDENTIAL

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NEITHER WAS THE REASON. RATHER, IT IS COMPETITION FROM TWO MILLION BARRELS DAILY OF EXCESS PRODUCTION ON THE WORLD MARKET. MCCLINTOCK

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